COMMENTS

of the

NATIONAL CONSUMER LAW CENTER
NATIONAL ASSOCIATION OF CONSUMER ADVOCATES
CONSUMER FEDERATION OF AMERICA
NATIONAL COMMUNITY REINVESTMENT COALITION
WOODSTOCK INSTITUTE
U.S. PUBLIC INTEREST RESEARCH GROUP
CENTER FOR ECONOMIC JUSTICE
CONSUMERS UNION

Proposed Revisions to Regulations B, E, M, Z, DD and the Official Staff Commentaries Docket Numbers R-1167, 1168, 1169, 1170, 1171

January 30, 2004

The National Consumer Law Center, Inc. (NCLC) is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (5th ed. 2003) and The *Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp.), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC file these comments on behalf of low-income consumers.[1] These comments are also filed on behalf of the **National Association of Consumer Advocates, Consumer Federation of America, National Community Reinvestment Coalition, the Woodstock Institute, and U.S. Public Interest Research Group**.[2]

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[1] These comments were written by Elizabeth Renuart with assistance from Carolyn Carter.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

The **Consumer Federation of America** is a non-profit association of nearly 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

The **National Community Reinvestment Coalition** is a national association representing more than 600 community-based organizations who work daily to promote economic justice in America, and to increase fair and equal access to credit, capital, and banking services to traditionally under-served populations in both urban and rural areas.

We will first address the proposed regulatory and commentary changes involving the "clear and conspicuous" standard that cuts across several regulations and then discuss several other additions to Regulation Z and the Commentary that relate solely to the Truth In Lending Act.

I. CLEAR AND CONSPICUOUS STANDARD IN REGULATIONS B, E, M, Z, DD

The Board and Staff propose an expanded, more specific, and consistent version of the "clear and conspicuous" standard in Regulations B (relating to equal credit), E (relating to electronic fund transfers), M (relating to consumer leasing), Z (relating to truth in lending), and DD (relating to truth in savings). The Board and Staff suggest these changes to facilitate compliance by institutions in light of the consistency of the standard among these regulations and to ensure that consumers receive noticeable and understandable information.

We generally support this articulation of the standard. However, we think that the definition of the word "clear" is not adequately addressed in the new Commentary. In addition, the rules regarding typeface, type size and the addition of "other information" with the required disclosures need some revision. Below we discuss Regulation Z specifically but intend that our comments apply generally to the other Regulations at issue.

Under current interpretations of the "clear and conspicuous" standard in the Truth In Lending Act, the word "conspicuous" generally refers to whether the disclosure draws the consumer's attention.[3] Consequently, "conspicuous" addresses the appearance of the

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The **Woodstock Institute**, founded in 1973, is a nationally recognized resource on the credit and capital needs of low-income and minority communities. The Institute engages in applied research, policy development, and technical assistance to promote community economic development.
U.S. Public Interest Research Group is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.
The **Center for Economic Justice** is a non-profit organization that advocates on behalf of low-income and minority consumers on insurance, credit and utility issues before administrative agencies to promote greater availability and affordability of the basic services necessary for individual and community economic development.
Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life of consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 4 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] *See* Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002).

disclosure. On the other hand, courts have held that a disclosure is not "clear" if it is capable of more than one plausible interpretation.[4] This is a substantive standard.

The proposed Commentary mentions a version of the "clear" standard but its articulation is too broad. The Commentary admonishes creditors to "avoid explanations that are imprecise and readily subject to different interpretations."[5] "Readily subject to different interpretations" is broader than "capable of more than one plausible interpretation." The Board's formulation suggests that the alternate interpretation must jump out at the reader, or appear to be just as likely as the correct interpretation. Under the "capable of more than one plausible interpretation" formulation, a disclosure would not meet the conspicuousness standard if another reasonable interpretation was possible. This is a more appropriate standard for a law that is intended to convey information to consumers whose financial sophistication may be minimal.[6] In order to conform § 226.2(a)(27)-1(vi) of the Commentary to the developed case law, we urge the Board and Staff to substitute the following for the proposed subsection:

> *Avoid explanations that are capable of more than one plausible interpretation.*

Second, proposed § 226.2(a)(27)-2(ii) requires the use of typefaces and type-sizes that are easy to read. The rule then creates guidelines regarding type size: 12-point type will generally comply whereas less than 8-point type would likely violate the conspicuousness standard. However, in credit card solicitations and applications, Regulation Z mandates that the APR be disclosed in 18-point type.[7] The proposed Commentary appears to conflict with this regulation. Further, we believe that 8-point type should not be the threshold below which the type is likely to be too small. The following helps to visualize how small 8-point type appears to a reader:[8]

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[4] *See* Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)(where the financing agreement contained two paragraphs related to cancellation, one of which provided information about the federal three-day right and the other of which discussed a state law one-day right, the TILA notice of right to cancel was not clearly and conspicuously disclosed. *See also* Porter v. Mid-Penn Consumer Discount, 961 F.2d 1066, 1077 (3d Cir. 1992)(where notice of right to cancel could be read at least two ways, each of which triggered different implications, notice was not "clear"); Apgar v. Homeside Lending, Inc. (*In re* Apgar), 291 B.R. 665 (Bankr. E.D. Pa. 2003)(notice of right to cancel given to the co-owner wife not "clear" as it could be read at least four different ways).

[5] Proposed Official Staff Commentary § 226.2(a)(27)-1(vi).

[6] The 1992 National Adult Literacy Survey found that over 40 million Americans had very low levels of literacy skills. Only about 20% of the adult population was sufficiently literate to locate information in lengthy, dense text or complex tabular or graphical documents. Alan M. While & Cathy Lesser Mansfield, *Literacy and Contract*, 13.2 Stanford L. & Pol'y. Rev. 233, 235 (2002)(discussing results of this survey and its implications for consumer's ability to understand consumer credit contracts). Even more troubling is the finding that 79% of the adult population has limited quantitative literacy skills. This means that they cannot reliably apply arithmetic operations to numbers in written materials. Even more significantly, 96% of American adults cannot extract and compute credit cost information from contract and disclosure documents. *Id.* at 236-238.

[7] Reg. Z § 226.5a(b)(1).

[8] Note that the footnotes in these comments appear in 10-point type and are not that easy to read!

12 point
10 point
8 point

To correct these problems, we suggest that the § 226.2(a)(27)-2(ii) Commentary read as follows:

> *Use a typeface and type size that are easy to read and that comply with any specific requirements such as § 226.5a(b)(1).* Disclosures printed in less than 12-point type do not automatically violate the standard; *however, disclosures in less than 10-point type would likely be too small to satisfy the standard.*

Third, the new Commentary provides that other information may be added to required disclosures, such as contractual provisions, explanations of contract terms, state disclosures, translations, or sending promotional materials with the required disclosures.[9]

This broad language is quite troubling when applied to the TIL closed-end disclosures in the "federal box" and the notice of the right to cancel, in particular. As to the federal box disclosures, additional information should not be permitted if it contradicts or confuses the consumer when reviewing the required information. An example would be if the creditor placed the note rate next to the APR or the principal amount next to the amount financed. This type of practice should be prohibited by Reg. Z § 226.17(a)(1) but the broad language appears to undermine this rule.

Further, the notice must be on a separate document and clearly and conspicuously disclose certain information.[10] The Board has issued model forms to ensure creditor compliance.[11] While the sample notices do not contain any other information, the existing Commentary permits additional information, such as the itemization of the amount financed.[12] It does not expressly allow for the inclusion of contractual provisions, explanations of contract terms, state disclosures, translations or promotional materials.

However, the new Commentary may be interpreted to allow the addition of this type of unrelated and distracting information in the notice of right to cancel, even if it is a "separate" document. The right to cancel is an extremely important right. This right is so important that Congress extends the right to cancel from three days to three years if the creditor fails to give the notice or provide accurate information in it.[13] This right will be seriously undermined by creditors who include the types of additional information permitted by the proposed Commentary. The form could become long and verbose. The additional information will distract the consumer.

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[9] Proposed Official Staff Commentary § 226.2(a)(27)-3.
[10] Reg. Z § 226.23(b)(1).
[11] Model Forms H-8. H-9, G-6, G-7, G-8, G-9.
[12] Official Staff Commentary § 226.23(b)-2.
[13] 15 U.S.C. § 1639(f); Reg. Z Reg. Z § 226.23(a)(3).

Of most concern is the inclusion of information that may conflict with the TILA required information. A state may require a notice of cancellation and an explanation of that right, though that right may differ from the TILA cancellation rights. For example, the state may permit cancellation within ten days; whereas TILA only allows cancellation within three days, unless certain "material" disclosures are not also provided. If the state notice is added to the TILA notice, consumers will be confused and unsure how to exercise either right. The consumer may think she or he has ten days to cancel under TILA as well. A similar problem arose in a recent case and the court found that TILA notice was not clear and conspicuous because it was susceptible of more than one plausible interpretation.[14] The new Commentary attempts to address this problem by stating: "However, the presence of this other information may be a factor in determining whether the 'clear and conspicuous' standard is met." Unfortunately, this sentence is too broad and will not protect consumers from the concerns just described. "May be a factor" is permissive and gives the creditors and courts little guidance. A firm standard is necessary.

Thus, the new Commentary should be amended to state:

> *Except as otherwise provided, for example as in 226.17(a)(1) and 226.23(b)(1),* the "clear and conspicuous" standard does not prohibit adding to the required disclosures such items as contractual provisions, explanations of contract terms, state disclosures, and translations, or sending promotional material with the required disclosures. *However, the presence of other information will render the required information not clear and conspicuous if the required information is capable of more than one plausible interpretation when read together with the additional information.*

II. COMMENTS TO PROPOSED REVISIONS TO REGULATION Z AND THE OFFICIAL STAFF COMMENTARY DOCKET NUMBER R-1167

The remainder of these comments will focus upon several other proposed additions to Regulation Z and its Commentary under the Truth In Lending Act.

A. Modification of the Rescission Procedures and *Yamamoto v. Bank of New York*

Problem: Both the Truth In Lending Act and Regulation Z make it clear that, if the consumer has the extended right to rescind a mortgage loan and chooses to exercise it, the security interest and obligation to pay finance charges are automatically void.[15] This

[14] Williams v. Empire Funding Corp., 109 F. Supp. 2d at 359-360.
[15] 15 U.S.C. § 1635(b); Reg. Z § 226.23(d)(1).

is step one. During step two, the lender must return any money or property given by the consumer and take action to terminate the security interest within 20 days of receipt of the notice of cancellation. At step three, once the creditor has performed, the consumer must tender the property or loan proceeds (minus the finance charges, closing costs, and payments made) to the lender.

This sequence is a reordering of common law rules governing rescission.[16] Under the common law, the rescinding party must first tender the property she has received under the agreement before the contract may be considered void. The reversal of the rescission sequence in the TILA context is important to both consumers and to the goals of the Act. For example, a homeowner need not offer a lump sum of cash (often a large amount) or return home improvements until it is clear that the creditor voluntarily will honor the rescission or until a court forces the creditor to do so. This means that the consumer need not take the risk of relinquishing the proceeds or returning the goods, thereby giving up all bargaining power, only to find that the creditor still refuses to cancel. It also gives the consumer time to obtain the cash through refinancing or to seek a court order allowing for installment payments. Indeed, the consumer is unlikely to be able to refinance until the creditor's lien is removed, and the exact amount of the tender obligation has been determined. In addition, if the security interest were not void upon rescission, the creditor could go through with a foreclosure sale while the consumer was attempting to exercise the right to rescind. "Further, because rescission is such a painless remedy under the statute (placing all burdens on the creditor), it acts as an important enforcement tool, insuring creditor compliance with TILA's disclosure requirements."[17]

Due to the 1980 amendments to TILA, the Act now expressly allows courts to alter the rescission "procedures" to insure that the consumer or creditor meets their rescission duties.[18] Regulation Z states that a court may modify steps two and three.[19] It does not expressly allow a court to tinker with the first step, *i.e.*, the automatic voiding of the security interest and the release of any obligation to pay finance charges.[20]

Before the 1980 amendments, the Ninth Circuit held that, in some circumstances, rescission can be conditioned upon the consumer's tender even though the statute did not expressly authorize modification.[21] In 1986, however, that court decided *Semar v. Platte Valley Fed. Sav. & Loan Ass'n*.[22] There, the court refused to modify step one, as requested by the creditor. Instead, it deferred "to Congress' method of enforcing TILA and follow[ed] the plain language of the statutes."[23] In an accompanying footnote, the

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[16] *See* Williams v. Homestake Mortgage Co., 968 F.2d 1137, 1140 (11th Cir. 1992).
[17] Williams v. Homestake Mortgage Co., 968 F.2d at 1140.
[18] 15 U.S.C. § 1635(b).
[19] Reg. Z § 226.23(d)(4).
[20] Regarding the authority of the courts, Congress stated: "[C]ourts, at any time during the rescission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required by the act." S. Rep. No. 368, 96th Cong., 2d Sess. 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 236, 265 (emphasis added).
[21] *See, e.g.*, Palmer v. Wilson, 502 F.2d 860, 862-63 (9th Cir.1974).
[22] 791 F.2d 699 (9th Cir. 1986).
[23] 791 F.2d at 706.

court explained that the rescission "procedures" were not at issue and that cases cited by the creditor did not give courts the discretion to alter TILA's substantive provisions.[24]

In 2003, the Ninth Circuit issued a decision that upsets the *Semar* rescission apple cart.[25] Essentially, the court ruled that a trial court can modify the rescission sequence to assure that the homeowner repay the loan proceeds, without first determining if the rescission request is valid. Under this rationale, creditors will be encouraged to contest all rescission notices and move to dismiss in the hopes that the consumer cannot tender immediately. In essence, the court created a non-waiveable bond requirement: to get her day in court, a consumer must pay up first.

Solution: The Board and Staff appropriately recognized the problems this holding poses for consumers in effectuating their rights under TILA. Consequently, they placed an additional sentence at the end of the "modification" paragraph of the relevant Commentary:

> The consumer's substantive right to rescind under § 226.23(a)(1) and § 226.23(d)(1) is not affected by the procedures referred to in § 226.23(d)(2) and (3), or the modification of those procedures by a court.[26]

This language is very significant because it embodies the *Semar* distinction between the *substantive rights* of the consumer (the automatic voiding of the security interest and the elimination of the consumer's obligation to repay certain charges) and the *rescission procedures* mandated by Congress.[27]

Further, the Board and Staff made clear in the Supplementary Information accompanying this proposed change that: "The sequence of procedures should not affect consumers' ability under TILA to establish their substantive right to rescind and to have the lien amount reduced, which may be necessary before consumers are able to establish how they will refinance or otherwise repay the loan."

Unfortunately, the Supplementary Information detracts from this seemingly firm statement in the sentence immediately preceding it by stating: "Accordingly, where consumers seek rescission and the matter is contested by the creditor, a determination regarding consumers' right to rescind *would normally* be made before a court determines the amounts owed and establishes the procedures for the parties to tender any money or property." We urge that the Supplementary Information accompanying the final rule state that the determination of the amounts owed *must* be preceded by a decision on the issue of the validity of the cancellation by the consumer. However, a court could make

[24] *Id.* at 706, n. 15.
[25] Yamamoto v. Bank of New York, 329 F.3d 1167 (9th Cir. 2003).
[26] Proposed Official Staff Commentary § 226.23(d)(4). This sentence is also appended to the Commentary dealing with the right to rescind in open-end transactions. *See* Official Staff Commentary § 226.15(d)(4).
[27] Semar v. Platte Valley Fed. Sav. & Loan Ass'n., 791 F.2d at 706, n. 15.

these decisions almost simultaneously at a trial, hearing, or in a written order. In other words, the word "must" should be substituted for the phrase "would normally."

To maximize the clarity of the proposed Commentary, we suggest the Board and Staff add the following example:

> *For example, a court may condition the filing of the release of the security interest, as opposed to the automatic voiding of the lien, upon the consumer's tender and may allow the consumer a period of time to repay the tender and/or to pay it in installments.*

This language highlights that a court may not modify the substantive right that the lien is automatically void upon cancellation; whereas, it does have the authority to condition the filing of the release of the mortgage, a procedural step, upon the consumer's tender.

Applicability of the Additional Commentary: Since 1981, Regulation Z has specified that: "The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order."[28] The statutory construction principle of *expressio unius est exclusio alterius* (the mention of one thing implies exclusion of another) is appropriate in this situation. In other words, since 1981, Regulation Z has meant that *only* the procedures in subsections (d)(2) and (3) can be modified and *not* the rights described in subsections (a)(1) or (d)(1). For this reason, the action of the Board and Staff to add Commentary to emphasize the importance of Regulation Z is merely a clarification and not a change in the law. The Supplementary Information accompanying the Commentary addition should state that this addition is a clarification of existing law and is *immediately* effective. Otherwise, courts will be left to their own discretion as to the immediate versus prospective application of the Commentary. This discretion will likely lead to differing rules in different jurisdictions, the very thing the Commentary is attempting to avoid.

B. "Amounts" Disclosed as Dollar Amounts and *Carmichael v. The Payment Center*

Problem: The Seventh Circuit recently decided that a final balloon payment may be *described* rather than stated in a dollar amount.[29] In that case, the loan called for twelve monthly payments of $709.74 and a final large payment, according to the court, of "all unpaid principal and interest."[30] The payment was not stated in a dollar amount.

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[28] Reg. Z §§ 226.15(d)(4) and 226.23(d)(4). *See* 46 Fed. Reg. 20892 (Apr. 7, 1981).

[29] Carmichael v. The Payment Center, Inc., 336 F.3d 636 (7th Cir. 2003).

[30] In the section of the actual TIL disclosure statement that describes the payment schedule, it states: "all remaining principal balance. Last payment may be slightly larger/smaller due to a longer/shorter payment period." Only at the bottom of the TIL statement does the document mention a balloon payment and then states that the last payment would consist of "all unpaid principal and interest." The variation between these descriptions of the final payment results in two different calculations of the balloon payment. If the final payment is calculated according to the "all remaining principal balance" formula, the balloon payment would be about $68,749. On the other hand, if the final payment is calculated using the "principal plus

Under this court's rule, the consumer is not entitled to know the payment amounts in dollar amounts. Consequently, the consumer is left to guess, or worse, attempt to use a computer to figure out the math. This holding severely undermines the strength of the Act and Regulation Z, that is, the certainty in the TILA disclosures that consumers, creditors, assignees of loans, and examiners have relied upon since 1968.

Solution: Admirably, the Board and Staff have reacted to this holding in an expeditious and appropriate way. The Board proposed a succinct and perfect fix to the havoc that the Seventh Circuit's decision is bound to create. Proposed Regulation Z section 226.2(b)(5) states:

> Where the word "amount" is used in this regulation to describe disclosure requirements, it refers to a numerical amount.

We strongly support this language.

Unfortunately, the accompanying proposed Commentary unnecessarily muddies this clear rule. The first sentence of this subsection states that a creditor "would" state a dollar amount when disclosing the amount financed, finance charge, or amount of any payment. By listing three items in an unqualified way, the Commentary implies that these are the only amounts that might be provided numerically with dollar signs preceding them. In fact, there are many other disclosures, such as the total of payments, the downpayment, the itemization of the amount financed, and the total sale price, that must be stated as dollar amounts. In addition, the use of the word "would" is permissive, rather than mandatory. This combination could lead a court to conclude that a creditor may, but need not, disclose the finance charge, amount financed, and payments in dollar amounts and that other required cost disclosures need not be provided in dollar amounts. This possible interpretation codifies the *Carmichael* holding, the opposite intent of the Board as shown in proposed Regulation Z.

The first sentence of proposed Commentary § 226.2(b)-2 should be deleted or, alternatively, re-written to correct this problem as follows:

> *A creditor must state a dollar amount when disclosing terms, such as, for example, the amount financed, finance charge, periodic payments, and other "amounts."*

The second sentence of the proposed Commentary is also problematic. Essentially, it provides an exception from the "dollar" rule for open-end plans. It allows a creditor to explain how the amount of a finance charge will be determined by listing a percentage or a dollar amount in the disclosures provided before the first transaction is made. By putting the apparent qualifier, i.e., that this sentence refers only to open-end

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interest" method, the final payment would be about $69,437. The two different descriptions lead to $688 difference.

plans, at the end of the sentence, it appears to only qualify the portion of the sentence following the "or."

Further, the use of a percentage in disclosures provided before the initial transaction occurs is permitted either expressly or by implication in credit card plans in three situations. First, Reg. Z § 226.6(a)(4) allows an explanation of the amount of the finance charge, including a description of how any finance charge other than the periodic rate will be determined. Second, Reg. Z § 226.6(b) permits the explanation of how certain non-finance charges will be determined. Third, in the home equity line of credit context, Reg. Z 226.5b(d)(7) expressly permits the use of a percentage to describe the fees imposed by the creditor to open, use, or maintain the plan. The Commentary should specifically reference these provisions for clarity.

For these reasons, we suggest that the second sentence of proposed Commentary § 226.2(b)-2 should be re-written as follows:

> *In disclosures provided before the first transaction under an open-end plan, under § 226.6(a)(4), 226.6(b), or § 226.5b(d)(7), a creditor may explain how the amount of any finance charge or other amounts will be determined by stating a percentage (for example, where the fee is a percentage of each cash advance) or a dollar amount (for example, a minimum finance charge of $1.00).*

Applicability of New Regulation Z and Commentary: The word "amount" appears over six hundred times in Regulation Z, its appendices, and the Commentary and the express use of the word "dollar" in relation to the word "amount" is infrequent.[31] Reading the word "amount" in context even where the word "dollar" does not appear shows that the Board intended that amount refer to the dollar amount. For example, the disclosure rule regarding the amount financed and the itemization of the amount financed does not use the word "dollar" but describes a calculation that must be completed in order to accurately describe it. Consequently, the only reasonable interpretation is that the dollar amounts must be listed.[32] The conclusion is supported by the Board's Model Forms which show that dollar amounts are contemplated for a whole array of disclosures. Finally, in an early letter, the Staff opined that disclosing the "amount" of the payment, meant that the creditor must "compute and disclose the dollar amount of each payment."[33]

Creditors have known for years that an "amount" means a dollar amount, except where the Regulation or Commentary explicitly stated otherwise. The proposed Regulation Z and accompanying Commentary are only a clarification of existing law and

[31] This calculation was made by Nina Simon at AARP by running the "focus" function on a LEXIS search of 12 C.F.R. Part 226.
[32] Reg. Z §§ 226.18(b), 226.18(c); Official Staff Commentary § 226.18(c)-2(i).
[33] FRB Letter No. 469 [1969-1974 Transfer Binder] Cons. Cred. Guide (CCH) ¶ 30,669 (Apr. 19, 1971).

do not impose new requirements. Therefore, these clarifications should be applied immediately. The Supplementary Information should make this clear.

C. Service of the Notice of Right to Cancel on the Holder's Servicer and *Miguel v. Country Funding Corp.*

Problem: The Ninth Circuit recently decided that sending a timely notice of cancellation to a servicer is not effective as notice to the holder of the obligation.[34] However, the record contained evidence showing that the assignee had actual knowledge of the homeowner's cancellation letter within three years from the loan closing.[35] There appeared to be no dispute that the original creditor violated TILA by failing to provide a proper notice of the homeowner's right to cancel. Consequently, her right to cancel extended to three years. Further, the court repeatedly stated that the servicer was the agent of the holder. Despite these facts, the court refused to apply traditional agency principles to hold that notice to an agent is effective as to the principal.[36]

Solution: Regulation Z currently requires the creditor to provide the address of the creditor's place of business on the notice of right to cancel it must provide to the homeowner.[37] The Commentary permits the creditor to add the name and address of a designated agent on the notice, presumably in addition to the creditor's name and address or as a substitute.[38]

The proposed Commentary attempts to fix the unfair and inappropriate result of the *Miguel* decision. For that, we applaud the Board and Staff. We suggest some tinkering of the revision for clarity. Our suggestions also reflect the reality of the mortgage marketplace.

Most mortgages are sold on the secondary market or are securitized. These loans are often transferred multiple times. There are several entities involved in these transfers—original creditors, servicers, multiple assignees, custodians, and trusts. The servicer is the entity known to the homeowner because it collects the monthly payments, handles the escrow account for taxes and insurance, communicates with the loan holder, handles repayment plans if the homeowner gets behind, and hires an attorney to foreclose if that is necessary. The servicer may remain the same throughout these transfers, leading the consumer to believe that there have not been any transfers of the mortgage, especially

34 Miguel v. Country Funding Corp., 309 F.3d 1161 (9th Cir. 2002).
35 Miguel v. Country Funding Corp., Petition for Certiorari to the Supreme Court at 2 (March 24, 3003). The loan holder's admission can be found in the Order Denying Defendant Bank of New York's Motion For Summary Judgment, etc.," June 3, 1999.
36 Restatement (2d) of Agency §§ 9, 268.
37 Reg. Z §§ 226.15(b)(3), 226.23(b)(1)(iii).
38 Official Staff Commentary §§ 226.15(a)(2)-1; 226.23(a)(2)-1.

since the assignments are not always recorded in the registry of deeds.[39] Homeowners often believe that their obligation is owed to the servicer, and in fact a few servicers do own some of the obligations they service. Given how the mortgage market works, it is not surprising that homeowners may be confused about who really owns their loans.

The proposed Commentary states:

> Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission and the consumer sends the notification to someone other than the creditor or assignee, such as a third-party loan servicer acting as the creditor's agent, state law determines whether delivery to that person constitutes delivery to the creditor or assignee.

This suggested addition is somewhat confusing and does not directly address the reality of the market. First, the sentence is modified by the first clause. This seems to mean that only when the *creditor* failed to designate an agent for service of any cancellation notice does the rest of the sentence apply. In other words, what happens when the creditor designated an address for an agent but the homeowner's loan is now held by an assignee whose agent is servicing the loan? In that instance, it appears that new Commentary does not apply. Second, basing the rule entirely on state agency law invites creditors to attempt to evade rescission by placing language in their contracts with servicers stating that the servicer is not an agent.

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[39] The ability of the homeowner or her attorney to determine the true holder is even more complicated with the increasing use of "MERS," Mortgage Electronic Registration System. The MERS website describes itself this way:

> MERS was created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper. Our mission is to register every mortgage loan in the United States on the MERS® System.
> Beneficiaries of MERS include mortgage originators, servicers, warehouse lenders, wholesale lenders, retail lenders, document custodians, settlement agents, title companies, insurers, investors, county recorders and consumers.
> MERS acts as nominee in the county land records for the lender and servicer. Any loan registered on the MERS® System is inoculated against future assignments because MERS remains the nominal mortgagee no matter how many times servicing is traded.

http://www.mersinc.org/index1.htm. When MERS is the nominee, the consumer cannot determine the identity of the actual loan/mortgage holder from public records. MERS will appear in the land records. Further, any mortgage registered with MERS will never show the actual holder no matter how many times the mortgage is sold or transferred.

Further, a bright line rule provides most clarity for creditors, assignees, and consumers. For this reason and given the realities of how the marketplace works, service upon the servicer should constitute service upon the holder. However, if the consumer sends the cancellation notice to someone other than the creditor, holder, or servicer, then state agency law should apply to determine whether that entity is an agent and whether service on it constituted service on the creditor or holder. In addition, if the holder receives notice of the cancellation from any source, actual notice should suffice.

For these reasons, we suggest the following be added to the current Commentary provisions in § 226.15(a)(2)-1 and 21 226.23(a)(2)-1 to replace the proposed addition:

> *If the consumer sends the notification to the current servicer for the assignee, service upon the servicer constitutes service upon the assignee. If the consumer sends the notification to someone other than the creditor, servicer, or assignee, state law determines whether delivery to that person constitutes delivery to the creditor or assignee. If the creditor or assignee receives actual notice of the consumer's rescission, such notice is effective.*

Applicability of New Regulation Z and Commentary: Notice to the original creditor or assignee has been effective under TILA and Regulation Z since 1968.[40] Adding a provision that notice to the servicer constitutes notice to the assignee simply recognizes the reality of the market, *i.e.* that servicers are agents in fact of the assignees. The proposed Commentary is only a clarification of existing law and does not impose new requirements. Therefore, it should be applied immediately. The Supplementary Information should so state.

III. CONCLUSION

We appreciate the effort made by the Board and Staff to address the spate of recent appellate court decisions that contain erroneous interpretations of the Truth In Lending Act. These decisions have had very negative consequences for the homeowners involved in those particular cases. All of them were prevented from rescinding their mortgage loans and they could lose their homes through foreclosure sales as a result. Further, the faulty reasoning used in these cases is likely to spread to other courts, creating havoc for large numbers of homeowners. If the Board and Staff had not stepped in, the viability of certain critical provisions of the Truth In Lending Act would be in serious jeopardy.

[40] 15 U.S.C. § 1635(a)(notice to creditor); § 1641(c)(rescission is effective against an assignee). Section 1635(a) was contained in the original version of TILA as § 125(a). Pub. L. 90-321, 82 Stat. 153 (May 29, 1968). A version of assignee liability appeared in the same bill as § 130(d).